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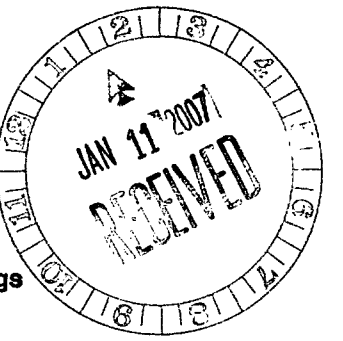

January 11, 2007

The Honorable Vernon Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

Re: Ex Parte No. 646 (Sub-No. 1) *Simplified Standards for Rail Rate Cases*

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and twenty copies of the Rebuttal Comments of Canadian Pacific Railway Company. A diskette containing an electronic version of the Rebuttal Comments is also enclosed.

Please acknowledge receipt of the enclosed Rebuttal Comments for filing by date-stamping the enclosed extra copies and returning them via our messenger. If you have any questions, please contact the undersigned counsel.

Sincerely,

Terence M. Hynes

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Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

REBUTTAL COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY

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Dated: January 11, 2007

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

REBUTTAL COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY

Pursuant to the schedule set forth in the Decision served on July 28, 2006 (the "*NOPR Decision*"), as modified by a Decision served on December 19, 2006, Canadian Pacific Railway Company and its U.S. subsidiaries, Soo Line Railroad Company and Delaware and Hudson Railway Company, Inc. (collectively "CPR"), submit these Rebuttal Comments regarding the Board's proposal to adopt simplified standards for small and medium sized rail rate cases.

As indicated in its prior comments, CPR supports the Board's overall objective of developing simplified procedures to reduce the burden and expense of litigating small and medium sized rate disputes. CPR believes that the multi-tiered approach proposed by the Board in the *NOPR Decision* represents a reasonable attempt to address the practical need to make such cases less complex and less costly without undermining the Board's longstanding CMP-based substantive standards for determining rate reasonableness. In particular, the proposed "Simplified SAC" ("SSAC") methodology offers shippers a simpler process for litigating medium sized rate disputes under substantive standards that remain, to a large degree, faithful to the principles of CMP. Although the Three-Benchmark ("3B") methodology for small cases would replace CMP-based ratemaking with a crude, comparison-based rate reasonableness standard, the *NOPR Decision* contemplates that the 3B test would be used "only as a last resort" in those few instances in which the value of the case cannot justify even a streamlined SSAC

inquiry. *NOPR Decision* at 11. If the Board adopts the modifications discussed in CPR's comments, and does not expand the applicability of the 3B test beyond the MVC threshold proposed in the *NOPR Decision*, the proposed rules will satisfy the dual statutory directives that the Board establish simplified rate procedures for cases in which a full SAC presentation would be too costly and that its substantive rate standards afford carriers the opportunity to achieve revenue adequacy.

The Joint Shippers argue that the Board should abandon its effort to craft "simplified" CMP-based rate procedures. Instead, they urge the Board to adopt a two-tiered ratemaking process (consisting solely of the SAC and 3B tests) and to "[d]rastically revise upwards" the MVC threshold for application of the SAC methodology. Jt. Shipper Reply at 3-4. BASF goes even further, arguing that "there is no need for eligibility thresholds and the MVC" and that shippers should be free in every case to decide which rate methodology will be applied. BASF Reply at 5.

These suggestions turn the Board's proposal on its head. Under the rate regime envisioned by shippers, only the very largest rate cases would be governed by CMP-based rate reasonableness standards. The vast majority of cases would instead be decided on the basis of an ill-defined "rate comparison" methodology that has little (if anything) to do with CMP and which fails to take account of the need for carriers to engage in differential pricing. Such a result would be flatly inconsistent with the Board's declaration at the outset of this proceeding that "CMP, with its SAC constraint, continues to be our preferred and the most accurate procedure available for determining the reasonableness of rail rates where there is an absence of effective competition." *NOPR Decision* at 9. It would also run afoul of the statutory goal of railroad revenue adequacy, as well as Congress' express statement that its directive that the Board

establish simplified rate procedures was "not intend[ed] to erode the Constrained Market Pricing principles adopted by the ICC for full stand-alone cost presentations." *See* S. Rep. 104-176 (1995) at 7.

Accordingly, the Board must not abandon its well-established CMP-based substantive rate reasonableness standards, including recognition of the need for railroads to engage in differential pricing. Rather, it should adopt final rules designed to reduce the time and expense required to litigate small and medium rate cases under substantive standards which, to the greatest extent possible, generate outcomes similar to those produced by a full SAC analysis.

I. ELIGIBILITY CRITERIA

A. The Board Should Not Increase The Proposed Eligibility Thresholds for Application of the SSAC and 3B Methodologies.

In their Reply Comments, the Joint Shippers urge the Board to eliminate the SSAC test and "drastically revise upwards" the MVC threshold for application of the 3B methodology. Jt. Shippers Reply at 3-4. In their initial comments, several other parties urged the Board to increase substantially the MVC thresholds for both the SSAC and 3B tests. *See, e.g.,* USDA Comments at 11 (proposing MVC of $1.6 million for 3B test and $15 million for SSAC); NGFA Comments at 15-18, 39-40. The Board should reject these proposals, and retain the eligibility thresholds set forth in the *NOPR Decision.*

Proponents of higher MVC thresholds proffered no data or other persuasive evidence that would support a significant increase in the MVCs proposed in the *NOPR Decision.* Indeed, shipper parties have made no serious attempt to quantify the likely cost of litigating a case under the streamlined SSAC methodology. Rather, they assert in conclusory fashion that the SSAC rules — under which most of the traffic and expense data required to support a complainant's case would be developed by the defendant carrier — would not reduce a shipper's litigation costs

significantly because the shipper would be required to "thoroughly check" the carrier-generated data. Jt. Shippers Reply at 15-16. The suggestion that it would cost just as much for a complainant to review traffic and cost data produced by the defendant railroad as it would to develop such data in the first instance is, at best, dubious. Moreover, the shippers ignore the obvious savings (in terms of both time and expense) that will result from the Board's proposals to eliminate altogether traffic selection issues, operating plans, and case-specific operating expenses, equipment expenses and construction unit costs in SSAC proceedings. Based upon the record to date, the Board's proposed MVCs for both the SSAC methodology and the 3B test are reasonable. A three-tiered rate process based upon those MVC thresholds would be consistent with Congress' intent that the Board apply CMP-based rate reasonableness standards where it is feasible to do so. *NOPR Decision* at 9. Accordingly, the Board should retain the MVC thresholds proposed in the *NOPR Decision.*

The Joint Shippers candidly predict that "almost every non-SAC complaint case will begin with a pitched battle involving the shipper's effort to overcome the eligibility presumptions" prescribed by the *NOPR Decision.* Jt. Shippers Reply at 12. This statement validates CPR's concern that making the results of the MVC calculation a "rebuttable presumption" will result in efforts by shippers to expand application of the 3B test. *See* CPR Comments at 4. It also foreshadows a substantial increase in the time and expense required to litigate rate cases, as shippers seek to avoid application of the methodology prescribed by the MVC test. The MVC thresholds, as proposed, already make simplified rate procedures available in the majority of rate disputes. The Board should not adopt open-ended eligibility criteria that encourage shippers routinely to seek exceptions to the procedures prescribed by the MVC

calculation. Rather, such exceptions should be granted (if at all) only in exceptional circumstances.

B. The Proposed SSAC and 3B Methodologies Should Not Be Applied In Cases Involving Cross-Border Traffic.

As CPR demonstrated in its initial comments (at 4-7), the SSAC and 3B methodologies cannot be applied to cases involving a movement between a point in the United States and a point in Canada because the data required to implement those methodologies do not exist for cross-border shipments.

Under the proposed SSAC methodology, the SARR's operating and equipment expenses would be estimated by applying the defendant carrier's system-average URCS costs for the Test Year to the SARR's traffic group. *See NOPR Decision* at 13, App. B. URCS data are available only for rail operations conducted in the United States. CPR Comments at 4-5. This problem cannot be overcome by applying the URCS costs of the U.S. carrier participating in a cross-border through shipment to the foreign segment of the movement. Each railroad's URCS system-average costs reflect that carrier's unique traffic mix, the terrain over which it operates, the terms of its labor agreements and a variety of other factors that affect its cost of operations. Canadian railroads operate over different terrain, with a different mix of traffic, in a different regulatory environment and under different labor arrangements than their U.S. counterparts. Thus, URCS cannot be used as a simplifying tool to develop operating and equipment costs for the Canadian portion of cross-border through movements. *Id.*

The proposed 3B methodology is even more dependent upon data that is not available for cross-border through shipments. Like SSAC, the 3B methodology would rely upon URCS to develop variable costs for both the issue movements and traffic within the comparison group. In addition, the revenues used to calculate R/VC ratios for both the issue traffic and the comparison

group would be drawn from the Waybill Sample maintained by the Board pursuant to 49 C.F.R. § 1244. However, the Waybill Sample does not include a complete sample of northbound cross-border movements, nor does it contain revenue information for the Canadian portion of all cross-border through movements. Thus, the Waybill Sample cannot be used to identify a reliable comparison group or to generate the revenue information needed to apply the 3B methodology in a case involving a challenge to a cross-border through rate.

KCS' Reply Comments indicate that "the same concerns exist with respect to through movements between the U.S. and Mexico." KCS Reply at 15. Specifically, KCS showed that URCS cost information does not exist for the portion of an international through movement that takes place in Mexico. Nor does the Waybill Sample include revenue data for the Mexican segment of cross-border through movements. *Id.* at 16.

No commenting party expressed opposition to CPR's proposal that the SSAC and 3B methodologies not apply to rate cases involving cross-border through movements.

Because the URCS and Waybill Sample data required to implement the SSAC and 3B methodologies in connection with rate disputes involving cross-border through shipments do not exist, the Board's final regulations should state that the SSAC and 3B tests will not be used where the issue traffic moves between a point in the United States, on the one hand, and a point in Canada or Mexico, on the other hand.[1] Clarifying the rules in this manner will provide parties

[1] The absence of URCS and Waybill Sample data cannot be circumvented by allowing shippers to challenge only the United States segment of a cross-border through movement. A shipper desiring to challenge the rate on a cross-border through movement must challenge the entire rate between origin and destination. *See Canada Packers, Ltd. v. Atchison, Topeka and Santa Fe Ry. Co.*, 385 U.S. 182, 183-84 (1966); *Great Northern Ry. Co. v. Sullivan*, 294 U.S. 458, 475 (1935); *Louisville & No. R.R. Co. v. Sloss-Sheffield Co.*, 269 U.S. 217, 234 (1925).

to a potential cross-border rate dispute certainty regarding the methodology that would be applied by the Board if such a dispute were presented to it.

CPR's proposal would not, as a practical matter, deny simplified rate procedures to a large number of cross-border shippers who otherwise might invoke them. Approximately 97% of the carloads of coal and 94% of the grain carloads that move over CPR's U.S. rail lines consists of US - to - US domestic shipments, which would not be affected by CPR's proposal. Overall, 84% of the revenue associated with CPR's cross-border traffic is attributable to movements that are "competitive" — i.e., traffic that originates at a point that is jointly served by CPR and another rail carrier, or at a truck reload/transload station. Given the competitive nature of most cross-border traffic, the rates for such shipments cannot be challenged before the Board under any rate methodology because the participating railroads do not possess market dominance with respect to such traffic. 49 U.S.C. § 10707. Indeed, the Board has not entertained a rate complaint involving cross-border traffic for more than 40 years. The vast majority of CPR's remaining (exclusively-served) cross-border traffic consists of southbound shipments that originate in Canada. Shippers of that traffic (and U.S. shippers of northbound cross-border through movements) have the ability to challenge CPR's rates pursuant to Canadian transportation legislation or before the Board under the SAC methodology.

II. SHIPPERS' ASSERTIONS THAT THE SSAC METHODOLOGY DOES NOT OFFER A LESS COMPLEX AND LESS EXPENSIVE RATE PROCEDURE THAN THE SAC METHODOLOGY ARE NOT CREDIBLE.

Shipper parties remain adamant in their desire to see the Board abandon the proposed SSAC methodology. In their Reply Comments, the Joint Shippers condemn SSAC as "unfair, unworkable and unlawful." Jt. Shippers Reply at 3. The Joint Shippers also assert that the SSAC test is "arbitrarily skewed to result in rates significantly higher than would result from a

Full-SAC case." *Id.* These claims are unsupported by the record evidence, and provide no basis for discarding the Board's SSAC proposal.

CPR's Reply Comments demonstrated that the criticisms of the SSAC methodology set forth in the shipper parties' initial comments are without merit. *See* CPR Reply at 8-13. The Joint Shippers' Reply Comments contain no new evidence to support their request that the SSAC methodology be withdrawn, nor do those comments offer any constructive proposals to mitigate the alleged shortcomings of the SSAC test. Rather, the Joint Shippers simply dismiss SSAC as "extremely expensive and complex." Jt. Shippers Reply at 12. Ironically, they attempt to support this assertion by referring to concerns expressed by the railroads regarding the burden imposed on railroad defendants to develop most of the traffic and cost information required for a SSAC case. *Id.* at 13-16. However, the obligations imposed on carriers under the "Second Disclosure" requirement substantially reduce the time and expense that would be incurred by a complaining shipper in bringing a SSAC case. The Joint Shippers' assertion that such information would not be "free" to the complainant, because it would still be required to "check" the data produced by the defendant carrier, cannot obscure the fact that the carrier's "Second Disclosure" would substantially reduce the complainant's burden in a SSAC proceeding.

Moreover, the Joint Shippers simply fail to acknowledge the substantial savings (in both time and expense) that will result from other simplifying features of the SSAC methodology. For example, the requirement that the SARR's traffic group consist of those movements actually handled by the defendant carrier over the selected route will eliminate the need for the complainant to analyze and select traffic, as well as the disputes over the propriety of the complainant's traffic selections that are common in SAC cases. The requirement that the SARR's physical configuration be based upon the defendant carrier's actual facilities will

likewise eliminate issues relating to SARR configuration that add to the complexity of SAC proceedings. The Board's decision to base the SARR's operating and equipment expenses on the defendant carrier's system-average URCS costs eliminates entirely the need for parties to develop case-specific operating plans and operating expenses. The adoption of construction unit costs based upon the results of recent SAC cases will streamline the process of estimating the cost of building the SARR. Shipper parties do not deny (nor could they) that these simplifying measures will make the cost of preparing evidence in a SSAC proceeding considerably less than the cost of a full SAC analysis.

The Joint Shippers' claim that the SSAC test is "arbitrarily skewed" to produce a higher rate than SAC in every case (Jt. Shippers' Reply at 3) is likewise unsupported by the record evidence. The Joint Shippers apparently assume that, because the SSAC methodology does not provide the same opportunity as the SAC test for a complainant to demonstrate that the defendant carrier's operations are inefficient, the rate produced by SSAC will always be higher than that resulting from a SAC analysis. However, the results produced by SAC and SSAC in a given case can be influenced by a variety of factors. For example, basing the SARR's traffic group on the defendant carrier's actual traffic, rather than a traffic group "selected" by the complainant, may produce differences in the SARR's revenues under the SAC and SSAC methodologies. Estimating SARR operating and equipment expenses using URCS, rather than developing case-specific operating and equipment costs, may produce lower SARR costs in a SSAC analysis by failing to take account of significant expense items associated with the SARR's traffic. Moreover, eliminating issues relating to the "feasibility" of the SARR operating plan posited by the complainant — issues with respect to which shippers have generally not fared

well in SAC cases – may enhance the shipper's prospects of obtaining more favorable outcomes under the SSAC methodology.

In short, the record does not support the Joint Shippers' claims that the SSAC methodology would systematically generate less favorable results for shippers, or that it would be just as complex and expensive to implement as the existing SAC test. To the contrary, the evidence demonstrates that SSAC offers a substantially less complicated and less costly procedure for litigating medium sized rate disputes under substantive standards that are, for the most part, consistent with CMP principles. The Board should adopt the SSAC methodology for cases with an MVC between $200,000 and $3.5 million.

III. THE BOARD SHOULD REJECT THE SHIPPERS' PROPOSALS TO EXPAND THE 3B METHODOLOGY.

The proposed 3B methodology represents a major substantive departure from CMP-based rate reasonableness standards. As CPR's Reply Comments (at 13-14) showed, determining the reasonableness of a rail rate on the basis of the mean R/VC for a group of supposedly "similar" movements would gut the concept of differential pricing, force rates to a system-average level and impair the ability of carriers to make necessary capital investments.[2] Widespread application of the 3B methodology would violate the fundamental tenets of railroad rate regulation articulated, and repeatedly confirmed, by the ICC/STB and the courts over the last two decades. It would also threaten to reverse the significant progress that railroads have made toward achieving the statutory goal of sustained revenue adequacy. Use of the 3B methodology, except in those few instances in which the value of a rate case cannot justify even a streamlined SSAC

[2] USDOT shares the railroads' concerns regarding the detrimental impact of applying the 3B test on a broad basis. *See* USDOT Comments at 6 ("repeated use of this [3-B] procedure could tend to lower the mean and reduce all rates to that level. Such an outcome would clearly have a detrimental effect on railroad incentives to make capital investments and improve service").

inquiry, would be contrary to law. For these reasons, CPR urges the Board to retain the proposed MVC threshold of $200,000 for application of the 3B methodology.

In addition, the Board must permit the parties in 3B cases to submit evidence relating to certain movement-specific adjustments to URCS system-average costs. As CPR's prior comments demonstrated, "unadjusted" URCS does not account for unique expenses (including third party payments, special handling requirements and the cost of complying with customs and safety regulations) that add substantially to the cost of transporting certain types of shipments. *See* CPR Comments at 12-14. Failing to take account of such costs in calculating R/VC ratios for the issue traffic and movements in a comparison group under the 3B methodology will produce "false comparisons" and arbitrary rate reasonableness determinations. If the Board decides to adopt a crude comparison-based methodology for small cases, it must ensure that the costs upon which such comparisons are based are as accurate as possible. Such accuracy can be achieved without substantially increasing the cost or complexity of 3B cases if the Board provides guidance regarding the types of adjustments that will be permitted.

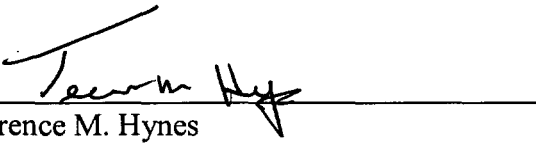
The Joint Shippers urge the Board to expand the scope of the 3B methodology in several ways. As discussed above, they ask the Board to "[d]rastically revise upwards" the MVC threshold for application of the SAC methodology, so that most rate disputes would be subject to litigation under the 3B test. *See* Jt. Shipper Reply at 3-4. For the reasons discussed above (and in CPR's prior submissions), the Board should not apply the 3B methodology to a broader category of rate disputes. Rather, the 3B test should be used only in those few cases in which it is impracticable to apply the streamlined SSAC methodology.

Moreover, the Joint Shippers propose that the results of the 3B test be viewed as nothing more than a starting point in determining the reasonableness of a challenged rate. Jt. Shippers

Reply at 4. *See also* Jt. Shippers Comments at 6. Specifically, they argue that a complainant should be permitted to seek a rate lower than that produced by the 3B rate comparison analysis by presenting evidence relating to a variety of factors, including carrier inefficiencies. *Id.* Indeed, the Joint Shippers go so far as to suggest that the rate resulting from application of the 3B methodology ought to be reduced to reflect "costs imposed on a shipper by erratic, unpredictable service." Jt. Shippers' Reply at 25.

Broadening the scope of 3B proceedings in the manner proposed by the Joint Shippers would defeat the very purpose of the 3B methodology — i.e., to provide a simple and inexpensive procedure for determining rate reasonableness in cases with very low MVCs. In particular, the Joint Shippers' proposal to introduce evidence relating to carrier "inefficiencies" in 3B cases flies in the face of the Board's determination to eliminate such issues even in cases under the SSAC methodology. Such evidence is irrelevant to an analysis that is fundamentally based upon crude "rate comparisons" rather than CMP principles. Nor should expedited 3B rate proceedings be used as a forum for shippers to air grievances relating to the quality of carrier service. The Board should reject the Joint Shippers' invitation to broaden the scope of the 3B methodology in this manner.

Respectfully submitted,



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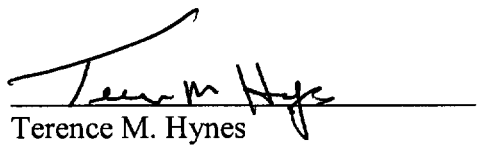
Dated: January 11, 2007

CERTIFICATE OF SERVICE

I hereby certify this 11th day of January 2007 that I have served all parties of record in this proceeding by first class mail, postage prepaid.



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